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European Initiative Influence upon Lithuanian SME Performance Measurement

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Abstract

The aim of this paper is to analyse how European Initiative on accounting administrative burden release will influence Lithuanian small and medium companies' performance measurement. Analysis of related literature, information comparison and generalization are used for European Union directives and Lithuanian information infrastructure overview. Empirical research is performed using survey method, for data evaluation descriptive statistics method as well as qualitative (systematization, classification, causal, functional and structural links analysis) and quantitative data analysis (quantitative indicators calculation) was applied. The empirical research results revealed that Lithuanian SME companies still lack even distribution and balance of financial and non-financial key performance indicators thus meaning they are still not adapted to forthcoming accounting and performance measurement changes influenced by EU initiative. The comprehensive analysis of EU directives and other law acts as well as Lithuanian information infrastructure analysis enables to forecast the SME performance measurement perspectives. The significant decrease of financial data accessibility is being forecasted as the main subsequence of forthcoming EU initiative thus changing accounting environment and practise.

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Keywords: European Union Initiative; SME performance measurement; Financial and non-financial key performance indicators.

Introduction

The subjects of small and medium enterprises compose the most numerous country's social group, the near-term forecasts of European Union allows for SME growth in all business sectors, in parallel the availability of financial

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data will decrease due to EU initiative regarding SME's. Meanwhile the performance measurement of SME's still lack the financial and non-financial indicators balance. The aim of this study is to analyze how European Initiative on accounting administrative burden release will influence Lithuanian small and medium companies' performance measurement. The main goals of research are: 1) to overview European Union directives and Lithuanian information infrastructure and 2) to analyze balance among financial and non-financial key performance indicators in Lithuanian SME companies. Analysis of related literature, information comparison and generalization are used for European Union directives and Lithuanian information infrastructure overview. Empirical research is performed using survey method, for data evaluation descriptive statistics method as well as qualitative (systematization, classification, causal, functional and structural links analysis) and quantitative data analysis (quantitative indicators calculation) was applied. The empirical research results revealed that Lithuanian SME companies still lack even distribution and balance of financial and non-financial key performance indicators thus meaning they are still not adapted to forthcoming accounting and performance measurement changes influenced by EU initiative.

1. European Union Initiative on accounting administrative burden release

Small and medium companies in all over European Union generate 75% of Gross Domestic Product, all over the world – 70% of GDP, thus in the near future SME will play the main role both in innovation and economic development. In 2008 European Commission for the attainment of promotion and increasing growth of small companies has created Small Business Act regulating an initiative "Think Small First" which is based on ten main principles. In the Act EU Member States are recommended for specific political means thus ensuring more beneficial business conditions, promoting enterprise, economic growth and assisting small companies for stable growth. The implementation of Small Business Act enables goals of strategy "Europe 2020" achievement to increase the competitiveness and stability of small companies, improve business environment and release administrative and regulating burden. Small companies have limited resources for high administrative and regulation requirements fulfilment. Financial statement announcement can be burden for such companies. European Parliament and Council on the 26th of June 2013 confirmed the Directive designed to simplify Accounting Directive's attitude regarding simplified financial accountability for very small companies. If there are no specific regulations for very small companies, they must follow small companies' regulations. In such a way very small companies get disproportionally to their size high burden compared to other small companies.

Therefore European Union started an initiative to enable Member States to exempt very small companies from some specific obligations influencing unnecessary administrative burden. Exemptions for very small companies (all or some) (EU Directive 2013/34/EU): to draw up only an abridged balance sheet, an abridged profit and loss account, abridged notes to their financial statements. They can be refused from the obligation to present Prepayments and accrued income and Accruals and deferred income and allowed to exempt from a general publication requirement, provided that balance sheet information is duly filed, in accordance with national law, with at least one designated competent authority. Member States must ensure that this Directive was followed. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 20 July 2015. Member States may provide that the provisions referred to in the first subparagraph are first to apply to financial statements during the calendar year 2016. By 20 July 2018 the Commission shall submit to the European Parliament, to the Council a report on the situation of very small companies taking account, in particular, of the situation at national level regarding the number of undertakings covered by the size criteria and the reduction of administrative burdens resulting from the exemption from the publication requirement.

This European Union Directive will ensure the possibility for the majority of SME (88%) to provide creditors and management with more relevant, general and more comprehensible financial information. This will influence more complicated statistical data accessibility because the public financial information of very small companies will significantly decrease. When creditors evaluate partners' reliability, credit risk and sales potential, they will seek for an alternative information about small companies. This factor will influence external small companies' evaluation changes. Therefore it will be extremely important for them into internal performance measurement to integrate as much non-financial indicators as possible and constantly monitor external evaluation methodology changes thus ensuring possibility to adapt and seek for stable growth results.

2. Credit risk and creditworthiness evaluation

In daily business activities companies face various risks: political, commercial, fraud, industrial, juridical, financial and other. In the scientific literature there are various different classifications which are based on different classification criteria (source, impact, business area, time, level, organisation etc). Accordingly there is no common classification still most frequently mentioned risks in scientific literature are business and financial. Company activity's risk arises when business processes are not clearly defined, poorly related to business strategy, do not increase capital, do not protect resources from thriftless usage (Mackevičius, 2005). This risk arises when human resources are inappropriate to realize business strategy, there is a lack of know-how, business cycle term is protracted. Financial risk outlines insufficient counterbalance of financing costs (Mackevičius, 2005). Companies with high financial risk have inefficient processes in managing price, liquidity and credit risks. The latter (credit risk) evaluation and management is of the most relevant topics in financial risk management area (Boguslauskas et al., 2011). Credit risk is a financial risk when creditor face loses because debitor does not repay obligations or carries out them unduly, in other words, as J. Bessis (2011) defines these risk sources, because of debtors reverse of creditworthiness quality though obligations ignorance can be also deliberate (Leipus, Valužis, 2006; Boguslauskas et al., 2011). Common risks rules are also applicable for credit risk: it is related to profit, high profit and low risk are contradictory goals. There is a very low probability to get high profit when risk is very low. When risk increases, as well loses do, thus it is extremely important to evaluate risk, define cut – off (acceptable risk level) considering business goals, explore risk influencing factors and reasons and according to set cut-off proportionally react to it and thus ensure effective credit risk management (Mackevičius, 2005; Crouhy et al., 2006; Kanapickienė, 2008; Breden, 2010; Giriūnas, 2012; Osborne, 2012; Passenheim, 2013). Credit risk is managed with partners and suppliers creditworthiness evaluation.

Creditworthiness – it is the ability of individual or juridical subject to apply financial obligations on time. Business partners and stakeholders are interested in having business relations with financially reliable and solvent company. Insolvency of one business subject makes significant influence upon others because irrecoverable investments from insolvent business partner causes the lack of cash flow for other in such a way procuring insolvency or even bankruptcy (Rugenytė et al., 2010). Thus in scientific literature good company's creditworthiness or solvency is being indicated as one of the factors for successful company's activity and competitiveness (Boguslauskas, 2006; Mackevičius, 2010). Financially reliable companies are much more confident and trustful by partners. Therefore creditworthiness should be integrated into SME performance measurement process: companies should follow their creditworthiness and creditworthiness evaluation methodology thus ensuring strategically important financial reliability.

3. Information infrastructure in Lithuania

While European Union initiates to release very small companies administrative burden and to simplify or exempt from financial accountability thus decreasing financial data accessibility, in scientific literature the importance of financial information for company's evaluation is not questioned. Therefore it seemed rational to explore the population distribution of Lithuanian companies which provide financial statements and those which do not, because financial information still constitutes significant part of accessible information about Lithuanian companies. As Table 1 shows, only 20% Lithuanian active companies provide financial statements and, what is more, due to EU initiative this number in next decade will be significantly lower.

Table 1. Lithuanian companies population distribution (according to financial statements provision)

Companies characteristics		Number of companies, 2014	Part in whole LT companies population
Companies, providing financial statements	Incl. JSC, SC, Agricultural companies etc. Financial sector not incl.	43 000	20%
Companies, not providing financial statements	Incl. Commercial companies: individual comp., JSC, Financial sector, governmental, cultural comp. not incl.	62 000	29%
	JSC without employees.	37 000	17%

Statistically not rated companies	Companies with juridical form: association, public, budgetary etc. Companies registered before 3 years or earlier. Financial sector companies. Liquidated companies.	76 000	35%
	Total:	218 000	

Ensure Considering these statistics, market needs and seeking to facilitate creditworthiness evaluation of the majority of Lithuanian companies, Lithuanian credit bureau has created rating model which forecast company's bankruptcy thus enabling to evaluate solvency of companies without financial statement data. This model enables objective statistical external creditworthiness evaluation for 65% of 218 thousand Lithuanian companies. In rating model without financial data company's turnover approximation has been used in order to apply analogous variables as in model with financial data. Approximation is founded on company's activity sector and number of employees:

$$approx.turnover = f(NrEmpl, sector), \text{ where}$$

NrEmpl is scale mean of last year number of employees and *sector* is company's commercial activity sector. The counterbalance of financial variables – company's age and sector's interaction.

Table 2. Information's importance in statistical creditworthiness evaluation models

Information type	Creditworthiness evaluation of companies without financial data	Creditworthiness evaluation of companies with financial data
General information	21%	6%
Negative information	54%	34%
Business inter-connections	23%	13%
Activity in the market	2%	2%
Financial information	-	45%

In Table 2 the comparison of information importance in both statistical creditworthiness evaluation models is provided. Companies' which do not provide financial information, general, negative and inter-connection information's importance is significantly higher than latter information of those which announce financial statements. As we can see in the Table 2, when there is no financial data, other variables become more significant, extremely high value gets negative information – company's payments to creditors and suppliers.

It can be concluded that company's creditworthiness evaluation, using econometrical statistical forecasting methods, can be accomplished both with and without financial statement information. When EU Directive accounting administrative burden release will inure, lower financial data accessibility will not limit neither statistical creditworthiness evaluation nor evaluation effectiveness, specifically adapted rating models with redistributed variables will be used for creditworthiness evaluation instead.

4. Financial and non-financial key performance indicators balance in Lithuanian SME companies

Aiming to analyse the balance among financial and non-financial key performance indicators in Lithuanian SME companies reconnaissance research is performed. The results of this empirical research will not be extrapolated to all Lithuanian SMEs population, instead they will be used to set the relevance of creditworthiness evaluation and need for integration into performance measurement process. The research is performed using survey method. The target survey group consists of the highest level SMEs managers (CEO). Panniott formula was applied to set representative sample size and finally it was concluded that for the research up to 123 respondents will be enough (Valackienė, 2004). Sample size of empirical research when the population is higher than 5000, with margin of error 9-10%, there was selected 96-123 sample size interval. As the empirical research results will not be used for extrapolation to all population they will be used only as confirmation / negation whether creditworthiness evaluation is relevant to small and medium companies, the margin of error 9-10% is appropriate. The data for empirical research was collected during 2014. 101 highest level managers (CEO) participated in a survey, 75 of them where the owners of their companies. Higher sample size was burdensome because respondents of this survey could be only the highest level managers or owners which is quite complicated. The distribution of respondents is heterogenic in business sectors and companies size according to number of employees perspectives therefore it is representative and enables to make reasonable conclusions about creditworthiness motives and importance to Lithuanian SME's stable growth.

In order to find out whether performance measurement in SME companies is balanced, financial and non-financial key performance indicators balance is being analysed. According to research results, only 23% respondents define their performance measurement as analysis of financial indicators and their variation, 36% - as measurement of financial and non-financial performance indicators when several indicators measure various performance areas (sales, service process/production, customer satisfaction etc.) and 41% - as financial and non-financial indicators measurement when interrelated indicators influence final company's result. When analysing what part in performance measurement takes financial and non-financial indicators, it was found out that real proportion of financial and non-financial indicators in performance measurement is respectively 62% and 38% (see Figure 1). Research results show that more than in a half (55%) companies performance measurement financial indicators are dominant (the measurement of these indicators makes more than 50%). Most common ones are profitability and performance effectiveness indicators. 22% companies balance financial and non-financial indicators in their performance measurement process. The group of these companies contains even 68% companies which performed stable growth for the last 3 years. This enables to conclude that indicators balance and stable growth has inter-correlation.

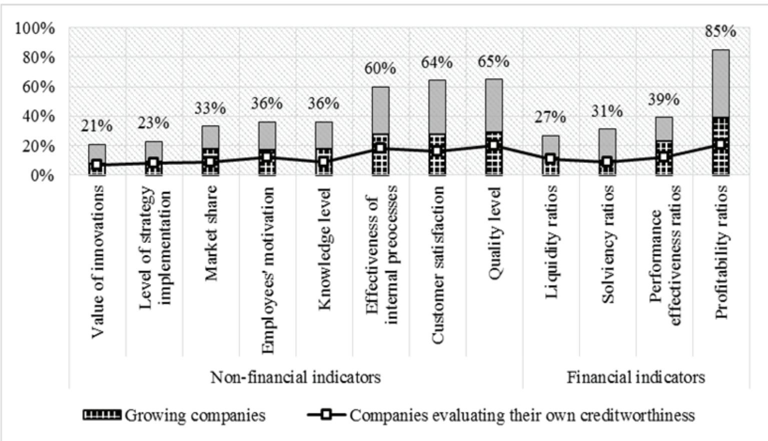

Fig. 1. Research results in respect to performance measurement indicators' distribution

Analyzing performance measurement periodicity, the latter was analysed in respect of financial and non-financial indicators (figure 2). More than a half companies measure performance monthly or quarterly. Preventively every half-year measure performance 22% respondents and only 10% measure performance less than twice a year but in the latter respondents group there were no companies which evaluate their own creditworthiness as more active performance measurement periodicity is typical for them. Positive point the research revealed is that in the majority of companies (57%) the measurement periodicity in respect of financial and non-financial indicators is alike. 28% of companies' measure financial indicators more often than non-financial ones and only 13% vice versa – prioritise non-financial indicators. But precisely in the latter group the majority of companies are evaluating their own creditworthiness.

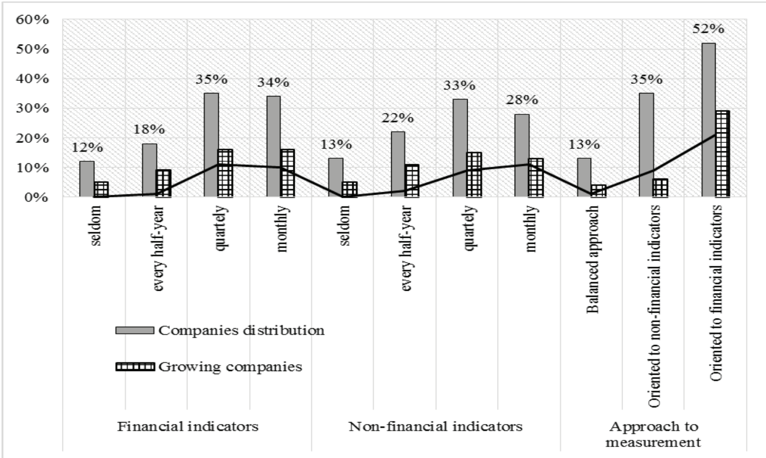

Fig. 2. Research results in respect to performance measurement indicators' balance

Summarizing, the periodicity of performance measurement in respect to financial and non-financial indicators is balanced though the approach to performance measurement and priorities distribution among financial and non-financial indicators is not such an even. Figure 2 illustrates that more than a half respondents have a financial indicators oriented approach to performance measurement. They reveal the conception that only financial indicators measurement enables to decide about company's effectiveness more than 50%, that financial indicators are easy-calculated and comparable, they provide objective information about company's performance. A non-financial indicators oriented approach to performance measurement is typical to third companies. Creditworthiness factor is also typical to them. The results of research revealed negative factor as well: the balanced performance measurement approach is typical only to 13% research companies. In their opinion, measurement of only financial indicators enables to evaluate company's effectiveness about 45-55%, measurement of financial indicators does not reveal reasons which cause performance results, is insufficient for comprehensive performance measurement, non-financial indicators provide information which is can be used for future perspectives planning and ranks increasingly more in performance measurement.

Conclusions

The comprehensive analysis of EU directives and EU initiative for small business enables to make grounded assumption that during next decade the accessibility and importance of financial information will decrease.

Only 20% Lithuanian active companies provide financial statements and, what is more, due to EU initiative this number in next decade will be significantly lower.

When EU Directive accounting administrative burden release will inure, lower financial data accessibility will not limit neither statistical creditworthiness evaluation nor evaluation effectiveness.

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